

May 27, 2005

Patrick C. Wilson
Assistant City Attorney
City of Santa Rosa
Office of the City Attorney
100 Santa Rosa Avenue
P.O. Box 1678
Santa Rosa, CA 95402-1678

Re: Your Request for Informal Assistance
Our File No. I-05-040

Dear Mr. Wilson:

This letter is in response to your request on behalf of Planning Commissioner Michael Arendt with the City of Santa Rosa, for informal assistance¹ regarding the provisions of the Political Reform Act (the "Act").² Nothing in this letter should be construed to evaluate any conduct which has already taken place. In addition, this letter is based on the facts presented. The Fair Political Practices Commission (the "Commission") does not act as the finder of fact when it renders advice. (*In re Oglesby* (1975) 1 FPPC Ops. 71.)

QUESTION

Does Commissioner Arendt have a conflict of interest in participating in Planning Commission decisions regarding projects involving customers of a bank that is a source of income to him?

¹ Informal assistance does not confer the immunity provided by a Commission opinion or formal written advice. (Regulation 18329(c)(3), copy enclosed.)

² Government Code sections 81000 – 91014. Commission regulations appear at Title 2, sections 18109-18997, of the California Code of Regulations. All statutory references herein are to the Government Code unless otherwise indicated. All regulatory references herein are to Title 2 of the California Code of Regulations unless otherwise indicated.

CONCLUSION

Commissioner Arendt will have a potential conflict of interest in participating in Planning Commission decisions involving customers of the bank if the decision will have reasonably foreseeable material financial effect on the bank, or if the nexus test is met, or if there is a personal financial effect on Commissioner Arendt as discussed herein.

FACTS

Michael Arendt is a planning commissioner with the City of Santa Rosa. Commissioner Arendt is employed as a First Vice President, Senior Savings Manager and Major Loan Officer with Luther Burbank Savings (LBS) located in Santa Rosa California.

Commissioner Arendt is paid a salary by LBS and is eligible for a semi-annual bonus. In a recent telephone conversation, you indicated that Commissioner Arendt's bonus is based on two factors: (1) the overall performance of the bank; and (2) Commissioner Arendt's management performance. Commissioner Arendt does not receive any commissions from loan customers of LBS nor is his bonus determined on the basis of increased business relating to specific and identifiable clients. He does not have an ownership interest in LBS.

As of December 2004, LBS had total assets in excess of \$1,600,000,000, total loans in excess of \$1,500,000,000 and total deposits in excess of \$1,200,000,000. Net income for LBS for 2004 exceeded \$34,000,000.

Customers of LBS may have development projects that come before the Santa Rosa Planning Commission for approval. These customers may have construction loans or mortgage financing from LBS thereby paying interest and fee income to LBS.

ANALYSIS

POTENTIAL CONFLICT OF INTEREST

The Acts conflict-of-interest provisions ensure that public officials will "perform their duties in an impartial manner, free from bias caused by their own financial interests or the financial interests of persons who have supported them." (Section 81001(b).) Section 87100 prohibits any public official from making, participating in making, or otherwise using his or her official position to influence a governmental decision in which the official has a financial interest.

The Commission has adopted an eight-step analysis for deciding whether an official has a disqualifying conflict of interest. (Regulation 18700(b).) The general rule is that a conflict of interest exists whenever a public official makes a governmental decision that has a reasonably foreseeable material financial effect on one or more of his or her financial interests.

STEPS 1 & 2: IS COMMISSIONER ARENDT A PUBLIC OFFICIAL MAKING, PARTICIPATING IN MAKING, OR INFLUENCING A GOVERNMENTAL DECISION?

As a member of the Santa Rosa Planning Commission, Commissioner Arendt is a public official under the Act. (Section 82048.)³ As a planning commissioner, he will be called upon to consider whether the City should approve or disapprove certain development projects that come before the planning commission. Therefore, he will be making, participating in making, or otherwise using his official position to influence a governmental decision.

STEP 3: DOES COMMISSIONER ARENDT HAVE A POTENTIALLY DISQUALIFYING ECONOMIC INTEREST?

A public official has a financial interest in a decision within the meaning of section 87103 if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official, a member of his or her immediate family, or on any one of five enumerated economic interests, including:

- An economic interest in a business entity in which he or she has a direct or indirect investment of \$2,000 or more (Section 87103(a); regulation 18703.1(a)); or in which he or she is a director, officer, partner, trustee, employee, or holds any position of management (Section 87103(d); regulation 18703.1(b));
- An economic interest in real property in which he or she has a direct or indirect interest of \$2,000 or more (Section 87103(b); regulation 18703.2);
- An economic interest in any source of income, including promised income, which aggregates to \$500 or more within 12 months prior to the decision (Section 87103(c); regulation 18703.3);
- An economic interest in any source of gifts to him or her if the gifts aggregate to \$360 or more within 12 months prior to the decision (Section 87103(e); regulation 18703.4);

³ If a public official's office is listed in section 87200 ("87200 filers" include city council members and members of planning commissions) and he or she has a conflict of interest in a decision noticed at a public meeting, then he or she must: (1) immediately prior to the discussion of the item, verbally identify each type of economic interest involved in the decision as well as details of the economic interest, as discussed in regulation 18702.5(b)(1)(B), on the record of the meeting; (2) recuse himself or herself; and (3) leave the room for the duration of the discussion and/or vote on the item. For closed sessions, consent [*14] calendars, absences and speaking as a member of the public regarding personal interests, special rules found in regulation 18702.5, subdivisions (c) and (d) apply. (Section 87105.) Since Commissioner Arendt is a member of the planning commission, these requirements are applicable to him if he determines that he has a conflict of interest in a governmental decision.

- An economic interest in his or her personal finances, including those of his or her immediate family -- this is the “personal financial effects” rule. (Section 87103; regulation 18703.5).

Under the facts you have presented, Commissioner Arendt has an economic interest in the business entity, (LBS), as an employee and as a source of income to him. (Section 87103 (c) and (d).) Regulation 18703.3(a)(1) further defines source of income to include any person from whom the public official receives commission income and *incentive compensation* as defined therein.

Regulation 18703.3, subdivision (d), which codified the Commission’s opinion in *In re Hanco*, (2002) 16 FPPC Ops. 1, provides that in certain circumstances relating to “incentive compensation” a “purchaser” may also be a source of income to an official. Regulation 18703.3(d) states:

“(d) Sources of Incentive Compensation. “Incentive compensation” means income received by an official who is an employee, over and above salary, which is either ongoing or cumulative, or both, as sales or purchases of goods or services accumulate. Incentive compensation is calculated by a predetermined formula set by the official’s employer which *correlates to the conduct of the purchaser in direct responses to the effort of the official*. Incentive compensation *does not include* : salary; commission income; bonuses for activity not related to sales or marketing, the amount of which is based solely on merit or hours worked over and above a predetermined minimum; and such executive incentive plans as may be based on company performance, provided that the formula for determining the amount of the executive’s incentive income *does not include a correlation between that amount and increased profits derived from increased business with specific and identifiable clients or customers of the company...* (emphasis added)”

It appears from the facts you have given that the bonuses Commissioner Arendt receives are an “executive incentive plan as may be based on *company performance*” that “does not include a correlation between that amount [the bonus given] and increased profits derived from increased business with *specific and identifiable clients or customers* of the company” (emphasis added).⁴ Accordingly, Commissioner Arendt does not have a source of income economic interest in any customers of LBS.

⁴ In *Hanco*, the public official was a pharmaceutical representative who received bonuses from her employer based on the overall sales of the company’s products within her territory. Although she marketed the product to healthcare providers, she was not involved in the actual sales transactions. However, her bonus was determined by a formula based on the number of sales of the represented product *within her territory*. Therefore, her incentive compensation was based on her directed sales or marketing efforts. The Commission found that “where a public official is employed to direct sales or marketing activity toward a business entity *such that there is a direct relationship between the purchasing activity of the entity and the amount of the incentive compensation the official receives, then the business entity will be a source of*

Finally, Commissioner Arendt also has an economic interest in his personal finances if the decision will result in an increase or decrease in his “personal expenses, income, assets, or liabilities.” (Section 87103.) These are the only economic interests identified from the facts presented.

STEP 4: ARE COMMISSIONER ARENDT’S ECONOMIC INTERESTS DIRECTLY OR INDIRECTLY INVOLVED IN THE GOVERNMENTAL DECISION?

“In order to determine if a governmental decision’s reasonably foreseeable financial effect on a given economic interest is material, it must first be determined if the official’s economic interest is directly or indirectly involved in the governmental decision.” (Regulation 18704(a).)

Sources of Income and Business Entities: For governmental decisions that affect sources of income and business entities, the standards set forth in regulation 18704.1(a) apply.

Regulation 18704.1(a) states:

“(a) A person, including business entities, sources of income and sources of gifts, is directly involved in a decision before an official’s agency when that person, either directly or by agent:

(1) Initiates the proceeding in which the decision will be made by filing an application, claim, appeal, or similar request or;

(2) Is a named party in, or is the subject of, the proceeding concerning the decision before the official or the official’s agency. A person is the subject of a proceeding if a decision involves the issuance, renewal, approval, denial or revocation of any license, permit, or other entitlement to, or contract with, the subject person.”

Since it does not appear that Commissioner Arendt’s source of income or business entity economic interest in the bank falls under the standards set forth in regulation 18704.1(a), the economic interest would be indirectly involved.

Personal Finances: For governmental decisions that affect personal expenses, income, assets, or liabilities, the standards set forth in regulation 18704.5 apply.

Regulation 18704.5 states:

income to the public official.” (In re *Hanko*, *supra*, p. 7.) In codifying this Opinion, regulation 18703.3(d) therefore provides an exception for bonuses relating to a company’s overall performance that are not tied to an individual’s efforts relating to certain “specific and identifiable client.” That exception applies to the facts herein.

“(a) A public official or his or her immediate family are deemed to be directly involved in a governmental decision which has any financial effect on his or her personal finances or those of his or her immediate family.”

Accordingly, if the governmental decision has any financial effect on the Commissioner’s income as a result of the bonuses he receives based on the bank’s overall performance, his personal finances would be directly involved in the governmental decision.

STEP 5: MATERIALITY STANDARD

Sources of Income and Business Entities: Regulation 18705.3(b)(1) states that for indirectly involved sources of income that are business entities, the materiality standards set forth in regulation 18705.1(c) apply. Regulation 18705.1(c) sets forth the materiality standards for an indirectly involved business entity. Accordingly, this materiality standard would apply to both Commissioner Arendt’s source of income economic interest and his business entity economic interest in LBS.

Your facts indicate that for its most recent fiscal year, LBS’s net income exceeded \$34,000,000. As a result, the materiality standard contained in regulation 18705.1(c)(2) applies. Under regulation 18705.1(c)(2), the financial effect of a governmental decision on a business in which a public official has an interest and which is indirectly involved in the governmental decision is material if it is reasonably foreseeable that:

“(A) The governmental decision will result in an increase or decrease in the business entity’s gross revenues for a fiscal year in the amount of \$500,000 or more; or,

(B) The governmental decision will result in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$200,000 or more; or,

(C) The governmental decision will result in an increase or decrease in the value of the business entity’s assets or liabilities of \$500,000 or more.”

“Nexus Rule”

Additionally, under the “Nexus Rule,” there is a separate and distinct materiality standard that applies in cases where there is a “nexus” between duties owed to a source of income and to the official’s public agency. This rule is stated in regulation 18705.3(c) as follows:

“Nexus: Any reasonably foreseeable financial effect on a person who is a source of income to a public official is deemed material if the public official receives or is promised the income to achieve a goal or purpose which would be achieved, defeated, aided, or hindered by the decision.”

You have not presented enough facts for us to analyze this issue. However, Commissioner Arendt should consider whether the governmental decision will achieve a goal or purpose which will have a reasonably foreseeable financial effect on LBS and for which the Commissioner will receive income. In other words, since Commissioner Arendt is receiving income in the form of bonuses based on the bank's performance, if the decision has a reasonably foreseeable financial effect on the bank's performance, the nexus test would apply, and the financial effect would be deemed material.

Personal Finances: Regulation 18705.5(a) states that a “reasonably foreseeable financial effect on a public official's personal finances is material if it is at least \$250 in any 12-month period.” Accordingly, if the reasonably foreseeable material financial effect of the governmental decision would result in an increase or decrease in LBS's performance figures used to calculate Commissioner Arendt's bonuses, and his bonus was thereby affected by at least \$250 in any 12-month period, Commissioner Arendt would have a conflict of interest prohibiting him from participating in the decision.

STEP 6: REASONABLY FORESEEABLE

An effect upon economic interests is considered “reasonably foreseeable” if there is a substantial likelihood that it will occur. (Regulation 18706(a).) Whether the financial consequences of a governmental decision are substantially likely at the time the decision is made depends on the facts surrounding the decision. A financial effect need not be certain to be considered reasonably foreseeable, but it must be more than a mere possibility. (*In re Thorner* (1975) 1 FPPC Ops. 198.)

You have not provided any facts regarding the nature of the governmental decision or the foreseeability of the potential financial effects on any of the economic interests. However, once the Commissioner has determined that there is reasonable foreseeability of a financial effect on one or more of his economic interests with respect to the specific governmental decision involved he may apply the materiality standards as set forth above. Should you need further assistance with respect to this question, you may request separate advice based on the factors presented with regard to the specific governmental decision involved.

STEPS 7 AND 8: PUBLIC GENERALLY & LEGALLY REQUIRED PARTICIPATION

You have not presented any facts indicating that either the “public generally” or “legally required participation” exceptions would be applicable herein.

If you have any other questions regarding this matter, please contact me at (916) 322-5660.

Sincerely,

Luisa Menchaca
General Counsel

By: William J. Lenkeit
Counsel, Legal Division

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